

**REPORTS ON THE AUDIT OF THE
THREE FORKS REGIONAL JAIL AUTHORITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
AND THE REVIEW OF
THREE FORKS REGIONAL JAIL - CONSTRUCTION RELATED COSTS
AND SPECIFIED FINANCIAL STATEMENT ASSERTIONS
FOR THE FISCAL YEARS ENDED JUNE 30, 2002 AND 2003**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

June 13, 2005

Richard Adams, Chairperson
Three Forks Regional Jail Authority
2475 Center Street
Beattyville, KY 41311

Dear Mr. Adams:

Attached, at your request and from the Governor's Office for Local Development, the Auditor of Public Accounts has performed the following services which are herein contained:

An Audit of the Three Forks Regional Jail Authority for the fiscal year ended June 30, 2004 and a Review of Three Forks Regional Jail - Construction Related Costs and Specified Financial Statement Assertions for the fiscal years ended June 30, 2002 and June 30, 2003.

Sincerely,

A handwritten signature in cursive script, reading "Crit Luallen".

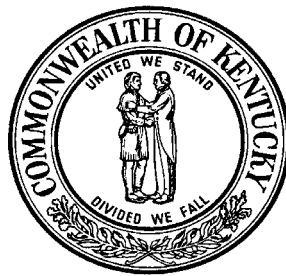
Crit Luallen
Auditor of Public Accounts

c: Cordell Lawrence, Deputy Commissioner, Governor's Office for Local Development
Three Forks Regional Jail Authority Board
Honorable L.C. Reese, Lee County Judge/Executive
Honorable Cale Turner, Owsley County Judge/Executive
Honorable Raymond Hurst, Wolfe County Judge/Executive
Kelly White, Director of Local Facilities, Department of Corrections



**REPORT OF THE AUDIT OF THE
THREE FORKS REGIONAL JAIL AUTHORITY**

**For The Fiscal Year Ended
June 30, 2004**



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EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE THREE FORKS REGIONAL JAIL AUTHORITY

June 30, 2004

The Auditor of Public Accounts has completed the review of the Three Forks Regional Jail construction related costs and the specified financial statement assertions for FYE June 30 2002 and 2003 and the audit of the Three Forks Regional Jail Authority for fiscal year ended June 30, 2004.

We have issued an unqualified opinion on the governmental activities, business-type activities, and each major fund of the Three Forks Regional Jail Authority.

On October 6th, 2000, the Counties of Lee, Owsley, and Wolfe (the participating counties) entered into an Interlocal Cooperation Agreement in order to provide for joint and cooperative action in the acquisition, construction, installation, maintenance and financing of the Three Forks Regional Jail. Pursuant to this interlocal agreement, Lee County (the lead county) established the Three Forks Public Properties Corporation, a legally separate organization, to act as an agency and instrumentality of the participating counties in financing the acquisition and construction of the Three Forks Regional Jail. On December 1, 2000, the corporation issued \$6,295,000 of first mortgage revenue bonds.

The only source of funds expected by the Three Forks Public Properties Corporation to meet the debt service requirements on the bonds are the rental payments from the participating counties, as stipulated in the lease and sublease agreements dated October 1st, 2000. Pursuant to the lease and sublease, each participating county covenants to meet its proportionate share of the debt service requirements on the bonds as follows (the "proportionate share" or "use allowance"): 40% for Lee County, 22% for Owsley County and 38% for Wolfe County.

By execution of the lease and subleases, each county is obligated for the amount of its proportionate share, plus any operating cost allowance required under the lease and subleases.

Each county is liable solely for its own proportionate share of total annual debt service on the bonds and no one county is liable for another county's debt. Payment of the annual debt service on the bonds is dependent upon each participating county paying its respective amount of its use allowance as rent under the lease or sublease, as the case may be, in full.

Each county has agreed in its lease and sublease agreements that in the event a county can not pay its indebtedness, an Ad Valorem Tax will be levied in that county for the amount sufficient to provide full payment of the county's rentals due for that year.

On December 1, 2000, the three participating counties established the Three Forks Regional Jail Authority pursuant to the provisions of KRS 441.800 and KRS 441.810 to act as the constituted authority of the participating counties in the acquisition, construction, equipping and operation of the Three Forks Regional Jail.

It is anticipated under the management agreement that the three participating counties will share equally in the operational costs of the facility based on a daily bed allocation of 15 beds at \$25 per day on a take-or-pay basis. It is anticipated under the management agreement that the counties will not be required to make additional payments to the operation of the facility; however, should there be a shortfall in operating revenue, the counties will pay equally to the authority, those moneys required to meet the debt service and operational costs.

EXECUTIVE SUMMARY

(Continued)

The Three Forks Regional Jail Authority and the Three Fork's Public Properties Corporation are comprised of an eight (8) member board of directors. Lee County appoints three of the eight members. Wolfe and Owsley counties appoint two members each. In addition, the Lee county jailer is a required member of the board.

Financial Condition:

The Three Forks Regional Jail Authority had net assets of negative \$(1,082,085) as of June 30, 2004. The Three Forks Regional Jail Authority had unrestricted net assets of \$59,710 in its governmental activities as of June 30, 2004, with total net assets of negative \$(1,093,422). In its business type activities, total unrestricted net assets were \$2,470 with total net assets of \$11,337. The Three Forks Regional Jail Authority had total debt principal as of June 30, 2004 of \$6,306,705 with \$262,511 due within the next year.

Report Comments:

- Substantial Doubt Of Three Forks Regional Jail's Ability To Continue To Operate Within Current Financial Structure
- Three Forks Jail Authority Defaulted On Debt Service Reserve Fund
- Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
- Three Forks Regional Jail Authority Did Not Comply With Governor's Office For Local Development Or Kentucky Revised Statutes
- Three Forks Regional Jail Authority Did Not Maintain, Record, And Report Capital Assets Properly
- Discrepancies Were Noted In Three Forks Regional Jail Authority's Payroll
- Three Forks Regional Jail Authority Did Not Charge Or Submit Sales Tax On Their Commissary Sales
- Three Forks Regional Jail Authority Commissary Fund Expenditures Were Not Used For The Benefit Or Recreation Of The Inmates
- Three Forks Regional Jail Should Establish Formal Policies Concerning Access To Computer System Resources
- Three Forks Regional Jail Authority Should Strengthen Network Logical Security

Deposits:

As of August 31, 2003, \$9,242 of the Three Forks Regional Jail Authority's deposits were uninsured and uncollateralized by bank securities or bonds.

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of Three Forks Regional Jail Authority, as of and for the year ended June 30, 2004, which collectively comprise the Authority's basic financial statements. These financial statements are the responsibility of the Three Forks Regional Jail Authority. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Fiscal Court Audits issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1, Three Forks Regional Jail Authority prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of Three Forks Regional Jail Authority as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with the basis of accounting described in Note 1.

The accompanying financial statements have been prepared assuming that the Three Forks Regional Jail will continue as a going concern. As discussed in Note 10 to the financial statements, the Three Forks Regional Jail has suffered recurring losses from operations and has a net asset deficiency that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Three Forks Regional Jail Authority has implemented Governmental Accounting Standards Board Statements 33, 34, and 37 as they relate to the modified cash basis of accounting as described in Note 1, which has altered the format and content of the basic financial statements.



To the People of Kentucky

Ellen Williams, Commissioner of the Governor's Office For Local Development
Honorable Richard Adams, Chairperson of the Three Forks Regional Jail Authority
Members of the Three Forks Regional Jail Authority

Three Forks Regional Jail Authority has not presented the management's discussion and analysis that the Governmental Accounting Standards Board (GASB) has determined is necessary to supplement, although not required to be a part of, the basic financial statements. The budgetary comparison information is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of budgetary comparison information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated May 31, 2005, on our consideration of Three Forks Regional Jail Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Based on the results of our audit, we present a schedule of comments and recommendations, included herein, which discusses the following report comments:

- Substantial Doubt Of Three Forks Regional Jail's Ability To Continue To Operate Within Current Financial Structure
- Three Forks Jail Authority Defaulted On Debt Service Reserve Fund
- Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
- Three Forks Regional Jail Authority Did Not Comply With Governor's Office For Local Development Or Kentucky Revised Statutes
- Three Forks Regional Jail Authority Did Not Maintain, Record, And Report Capital Assets Properly
- Discrepancies Were Noted In Three Forks Regional Jail Authority's Payroll
- Three Forks Regional Jail Authority Did Not Charge Or Submit Sales Tax On Their Commissary Sales
- Three Forks Regional Jail Authority Commissary Fund Expenditures Were Not Used For The Benefit Or Recreation Of The Inmates
- Three Forks Regional Jail Should Establish Formal Policies Concerning Access To Computer System Resources
- Three Forks Regional Jail Authority Should Strengthen Network Logical Security

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
May 31, 2005

THREE FORKS REGIONAL JAIL AUTHORITY OFFICIALS

For The Year Ended June 30, 2004

Lucy Burroughs	Chairperson
Travis Smith	Administrator
Jason Wilson	Attorney
Barbara Phillips	Secretary
Dennis Brooks	Member
Arthur Noe	Member
Norma Moore	Member
Dennie Begley	Member
Richard Adams	Member
Caroline Sizemore	Member
Misty Moore	Fiscal Officer

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**THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS**

June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2004

	Primary Government		
	Governmental	Business-Type	
	Activities	Activities	Totals
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 438,146	\$ 2,470	\$ 440,616
Total Current Assets	438,146	2,470	440,616
Noncurrent Assets:			
Capital Assets - Net of			
Accumulated Depreciation			
Land and Land Improvements	42,108		42,108
Buildings	4,709,190		4,709,190
Vehicles and Equipment	17,134	15,572	32,706
Total Noncurrent Assets	4,768,432	15,572	4,784,004
Total Assets	5,206,578	18,042	5,224,620
LIABILITIES			
Current Liabilities:			
Bonds Payable	85,000		85,000
Financing Obligations Payable	170,000	6,511	176,511
Total Current Liabilities	255,000	6,511	261,511
Noncurrent Liabilities:			
Bonds Payable	6,045,000		6,045,000
Financing Obligations Payable		194	194
Total Noncurrent Liabilities	6,045,000	194	6,045,194
Total Liabilities	6,300,000	6,705	6,306,705
NET ASSETS			
Invested in Capital Assets,			
Net of Related Debt	\$ (1,531,568)	\$ 8,867	\$ (1,522,701)
Restricted For:			
Debt Service	378,436		378,436
Unrestricted	59,710	2,470	62,180
Total Net Assets	\$ (1,093,422)	\$ 11,337	\$ (1,082,085)

The accompanying notes are an integral part of the financial statements.

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**THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS**

For The Year Ended June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

For The Year Ended June 30, 2004

		Program Revenues Received	Net (Expenses) Revenues and Changes in Net Assets		
			Primary Government		
Functions/Programs Reporting Entity	Expenses	Charges for Services	Governmental Activities	Business-Type Activities	Totals
Primary Government:					
Governmental Activities:					
Protection to Persons and Property					
Office of Administration					
Salaries-					
Administrator	\$ 49,418	\$ 42,335	\$ (7,083)	\$	\$ (7,083)
Deputies/Matrons	381,712	327,012	(54,700)		(54,700)
Medical Personnel	36,546	31,308	(5,238)		(5,238)
Secretary/Bookkeeper	49,451	42,365	(7,086)		(7,086)
Cooks	56,105	48,065	(8,040)		(8,040)
Maintenance Staff	30,506	26,135	(4,371)		(4,371)
Operations					
Prisoner Clothing	1,823	1,562	(261)		(261)
Staff Clothing	4,696	4,023	(673)		(673)
Cleaning Supplies	30,181	25,856	(4,325)		(4,325)
Kitchen Supplies	2,022	1,732	(290)		(290)
Office Supplies	3,903	3,344	(559)		(559)
Supplies - Other	6,984	5,983	(1,001)		(1,001)
Medical Services	27,939	23,935	(4,004)		(4,004)
Food	169,689	145,373	(24,316)		(24,316)
Gasoline	1,550	1,328	(222)		(222)
Linens	1,810	1,551	(259)		(259)
Prisoner Hygiene	2,683	2,299	(384)		(384)
Routine Medical	16,830	14,418	(2,412)		(2,412)
Travel	2,183	1,870	(313)		(313)
Utilities	80,373	68,856	(11,517)		(11,517)
Miscellaneous Expense	6,895	5,907	(988)		(988)
Maintenance					
Building Repairs	15,914	13,634	(2,280)		(2,280)
Equipment Repairs	424	363	(61)		(61)
Equipment					
Communication	2,840	2,433	(407)		(407)
Food Service	9	8	(1)		(1)
Debt Service	375,113	321,360	(53,753)		(53,753)
Depreciation Expense					
Buildings	136,498	116,938	(19,560)		(19,560)
Vehicles and Equipment	7,343	6,291	(1,052)		(1,052)

The accompanying notes are an integral part of the financial statements.

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2004
(Continued)

Primary Government: (Continued)

Governmental Activities: (Continued)

Administration

General Services

Professional Service	7,313	6,265	(1,048)	(1,048)
Building and Property Insurance	104,628	89,635	(14,993)	(14,993)
Staff Training	753	645	(108)	(108)

Fringe Benefits

Social Security	34,297	29,382	(4,915)	(4,915)
Retirement	37,807	32,389	(5,418)	(5,418)
Health Insurance	74,713	64,007	(10,706)	(10,706)
Unemployment	4,564	3,910	(654)	(654)
Worker's Compensation	28,551	24,460	(4,091)	(4,091)
Medicare	8,021	6,872	(1,149)	(1,149)
Fees	4,340	3,718	(622)	(622)

Total Governmental Activities	1,806,427	1,547,567	(258,860)	(258,860)
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Business-type Activities:

Jail Commissary	119,822	140,727	20,905	20,905
Total Business-type Activities	119,822	140,727	20,905	20,905

Total Primary Government	\$ 1,926,249	\$ 1,688,294	\$ (258,860)	\$ 20,905	\$ (237,955)
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General Revenues:

Transfers	40,097	(40,097)	
Miscellaneous Revenues	21,929	12,422	34,351
Accrued Interest Received	49,819		49,819

Total General Revenues	111,845	(27,675)	84,170
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Change in Net Assets	(147,015)	(6,770)	(153,785)
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Net Assets - Beginning	(946,407)	18,107	(928,300)
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Net Assets - Ending	\$ (1,093,422)	\$ 11,337	\$ (1,082,085)
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The accompanying notes are an integral part of the financial statements.

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THREE FORKS REGIONAL JAIL AUTHORITY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2004

	General Fund	Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 Fund	Total Governmental Funds
ASSETS			
Cash and Cash Equivalents	\$ 59,710	\$ 378,436	\$ 438,146
Total Assets	<u>\$ 59,710</u>	<u>\$ 378,436</u>	<u>\$ 438,146</u>
FUND BALANCES			
Fund Balances:			
Unreserved:			
General Fund	\$ 59,710	\$	\$ 59,710
Debt Service Fund		378,436	378,436
Total Fund Balances	<u>\$ 59,710</u>	<u>\$ 378,436</u>	<u>\$ 438,146</u>

Reconciliation of the Balance Sheet - Governmental Funds to the Statement of Net Assets:

Total Fund Balances	\$ 438,146
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities (Not financial resources and therefore are not reported in the funds.)	5,197,113
Accumulated Depreciation	(428,681)
Liabilities are not due and payable in the current period and, therefore, are not reported in the funds.	
Bonds Payable	(6,130,000)
Financing Obligations Payable	<u>(170,000)</u>
Net Assets Of Governmental Activities	<u>\$ (1,093,422)</u>

The accompanying notes are an integral part of the financial statements.

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**THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS**

For The Year Ended June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

For The Year Ended June 30, 2004

	General Fund	Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 Fund	Total Governmental Funds
REVENUES			
Charges for Services	\$ 1,547,567	\$	\$ 1,547,567
Miscellaneous	21,929		21,929
Interest, Conversions, Gains, Misc.		49,819	49,819
Total Revenues	<u>1,569,496</u>	<u>49,819</u>	<u>1,619,315</u>
EXPENDITURES			
General Government			
<u>Protection to Persons and Property</u>			
Office of Administration			
Salaries-			
Administrator	49,418		49,418
Deputies/Matrons	381,712		381,712
Medical Personnel	36,546		36,546
Secretary/Bookkeeper	49,451		49,451
Cooks	56,105		56,105
Maintenance Staff	30,506		30,506
Operations			
Prisoner Clothing	1,823		1,823
Staff Clothing	4,696		4,696
Cleaning Supplies	30,181		30,181
Kitchen Supplies	2,022		2,022
Office Supplies	3,903		3,903
Supplies - Other	6,984		6,984
Medical Services	27,939		27,939
Food	169,689		169,689
Gasoline	1,550		1,550
Linens	1,810		1,810
Prisoner Hygiene	2,683		2,683
Routine Medical	16,830		16,830
Travel	2,183		2,183
Utilities	80,373		80,373
Miscellaneous Expense	6,895		6,895
Maintenance			
Building Repairs	15,914		15,914
Equipment Repairs	424		424
Equipment			
Communication	2,840		2,840
Food Service	9		9
Debt Service		460,113	460,113

The accompanying notes are an integral part of the financial statements.

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
For The Year Ended June 30, 2004
(Continued)

EXPENDITURES (Continued)

General Government (Continued)

Administration

General Services			
Professional Service	7,313		7,313
Building and Property Insurance	104,628		104,628
Staff Training	753		753
Fringe Benefits			
Social Security	34,297		34,297
Retirement	37,807		37,807
Health Insurance	74,713		74,713
Unemployment	4,564		4,564
Worker's Compensation	28,551		28,551
Medicare	8,021		8,021
Fees		4,340	4,340
Total Expenditures	<u>1,283,133</u>	<u>464,453</u>	<u>1,747,586</u>
Excess (Deficiency) of Revenues Over			
Expenditures Before Other			
Financing Sources (Uses)	<u>286,363</u>	<u>(414,634)</u>	<u>(128,271)</u>
Other Financing Sources (Uses)			
2004 E KADD Lease Proceeds		170,000	170,000
Repayment of 2003 B KADD Lease		(165,000)	(165,000)
Transfers From Other Funds	40,097	334,728	374,825
Transfers To Other Funds	<u>(334,728)</u>		<u>(334,728)</u>
Total Other Financing Sources (Uses)	<u>(294,631)</u>	<u>339,728</u>	<u>45,097</u>
Net Change in Fund Balances	(8,268)	(74,906)	(83,174)
Fund Balances - Beginning	<u>67,978</u>	<u>453,342</u>	<u>521,320</u>
Fund Balances - Ending	<u>\$ 59,710</u>	<u>\$ 378,436</u>	<u>\$ 438,146</u>

The accompanying notes are an integral part of the financial statements.

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**THREE FORKS REGIONAL JAIL AUTHORITY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS**

For The Year Ended June 30, 2004

**THREE FORKS REGIONAL JAIL AUTHORITY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS**

For The Year Ended June 30, 2004

Reconciliation to the Statement of Activities:

Net Change in Fund Balances - Total Governmental Funds	(83,174)
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Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets are allocated over their estimated useful lives and reported as depreciation expense.

Depreciation Expense	(143,841)
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The issuance of debt provides current financial resources while the repayment of the principal on debt consumes current financial resources. Neither transaction, however, has any effect on net assets.

Proceeds -KADD Lease Series 2004 E	(170,000)
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Repayment of Financing Obligation - KADD Lease 2003 B	165,000
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Bond Principal Payments	85,000
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Change in Net Assets of Governmental Activities	\$ (147,015)
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THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF FUND NET ASSETS - PROPRIETARY FUND - MODIFIED CASH BASIS

June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF FUND NET ASSETS - PROPRIETARY FUND - MODIFIED CASH BASIS

June 30, 2004

	Enterprise Fund
	Jail Commissary Fund
Assets	
Current Assets:	
Cash and Cash Equivalents	\$ 2,470
Total Current Assets	<u>2,470</u>
Noncurrent Assets:	
Capital Assets:	
Vehicles and Equipment	22,900
Less Accumulated Depreciation	<u>(7,328)</u>
Total Noncurrent Assets	<u>15,572</u>
Total Assets	<u>18,042</u>
Liabilities	
Current Liabilities:	
Financing Obligations Payable	<u>6,511</u>
Total Current Liabilities	6,511
Noncurrent Liabilities:	
Financing Obligations Payable	<u>194</u>
Total Noncurrent Liabilities	<u>194</u>
Total Liabilities	6,705
Net Assets	
Invested in Capital Assets,	
Net of Related Debt	8,867
Unrestricted	<u>2,470</u>
Total Net Assets	<u>\$ 11,337</u>

The accompanying notes are an integral part of the financial statements.

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THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS -
PROPRIETARY FUND - MODIFIED CASH BASIS

For The Year Ended June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS -
PROPRIETARY FUND - MODIFIED CASH BASIS

For The Year Ended June 30, 2004

	<u>Enterprise Fund</u>
	<u>Jail Commissary Fund</u>
Operating Revenues	
Canteen Receipts	\$ 139,846
Miscellaneous	881
Total Operating Revenues	<u>140,727</u>
Operating Expenses	
Cost of Sales and Services	115,576
Depreciation	<u>3,664</u>
Total Operating Expenses	<u>119,240</u>
Operating Income	<u>21,487</u>
Nonoperating Revenues (Expenses)	
Payments from Outside Vendor	12,422
Interest Expense	<u>(582)</u>
Total Nonoperating Revenues	<u>11,840</u>
Income Before Transfers	33,327
Transfers Out	<u>(40,097)</u>
Change in Net Assets	(6,770)
Total Net Assets - Beginning	<u>18,107</u>
Total Net Assets - Ending	<u><u>\$ 11,337</u></u>

The accompanying notes are an integral part of the financial statements.

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THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF CASH FLOWS - PROPRIETARY FUND - MODIFIED CASH BASIS

For The Year Ended June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF CASH FLOWS - PROPRIETARY FUND - MODIFIED CASH BASIS

For The Year Ended June 30, 2004

	<u>Enterprise Fund</u>
	<u>Jail Commissary Fund</u>
Cash Flows From Operating Activities	
Receipts From Customers	\$ 139,846
Miscellaneous	881
Cost of Sales	<u>(115,576)</u>
Net Cash Provided By Operating Activities	<u>25,151</u>
Cash Flows From Noncapital Financing Activities	
Payments From Outside Vendors	12,422
Transfers Out	<u>(40,097)</u>
Net Cash Used By Noncapital Financing Activities	<u>(27,675)</u>
Cash Flows From Capital and Related Financing Activities	
Debt Service - Principal	(6,179)
Debt Service - Interest	<u>(582)</u>
Net Used Provided By Capital and Related Financing Activities	<u>(6,761)</u>
Net (Decrease) in Cash and Cash Equivalents	(9,285)
Cash and Cash Equivalents - July 1, 2003	<u>11,755</u>
Cash and Cash Equivalents - June 30, 2004	<u><u>\$ 2,470</u></u>
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities	
Operating Income	\$ 21,487
Adjustments:	
Depreciation	<u>3,664</u>
Net Cash Provided By Operating Activities	<u><u>\$ 25,151</u></u>

The accompanying notes are an integral part of the financial statements.

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**THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF FIDUCIARY FUND NET ASSETS - MODIFIED CASH BASIS**

June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
STATEMENT OF FIDUCIARY FUND NET ASSETS - MODIFIED CASH BASIS

June 30, 2004

Agency Fund

**Prisoner
Fund**

Assets

Current Assets:

Cash and Cash Equivalents	\$	<u>7,537</u>
---------------------------	----	--------------

Total Assets		<u>7,537</u>
--------------	--	--------------

Liabilities

Amounts Held In Custody For Others		<u>7,537</u>
------------------------------------	--	--------------

Total Liabilities		<u>7,537</u>
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Net Assets

Total Net Assets	\$	<u><u>0</u></u>
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The accompanying notes are an integral part of the financial statements.

**INDEX FOR NOTES
TO THE FINANCIAL STATEMENTS**

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**THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS**

June 30, 2004

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

The Three Forks Regional Jail Authority presents its government-wide and fund financial statements utilizing a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transactions, with a few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Accounts receivable, accounts payable, compensated absences, and donated assets, among other items, are not reflected in the financial statements.

The State Local Finance Officer does not require the Authority to report capital assets; however, the value of these assets are included in the Statement of Net Assets and their corresponding depreciation expense is included on the Statement of Activities.

B. Reporting Entity

The financial statements of Three Forks Regional Jail Authority include the funds for which the Authority is financially accountable. Financial accountability, as defined by Section 2100 of the Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14 and GASB 39, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Consequently, the reporting entity includes organizations that are legally separate from the primary government. Legally separate organizations are reported as component units if either the Authority is financially accountable or the organization's exclusion would cause the Authority's financial statements to be misleading or incomplete. Component units may be blended or discretely presented. Blended component units either provide their services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as the primary government. All other component units are discretely presented or shown separately from the primary government.

Blended Component Units

The following legally separate organization provided their services exclusively to the primary government. This organization's balances and transactions are reported as though they are part of the Authority's primary government using the blending method.

Three Forks Public Properties Corporation

The Three Forks Public Properties Corporation was established on October 6, 2000, by Lee County, to act as an agency and instrumentality of the participating counties in financing the acquisition and construction of the Three Forks Regional Jail. The three participating counties are financially accountable and legally obligated for the debt of the Three Forks Public Properties Corporation as stipulated in each county's lease and sublease.

Discretely Presented Component Units

The Three Forks Regional Jail Authority has no discretely presented component units.

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

C. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all governmental and business-type activities of the Authority and its non-fiduciary component units. For the most part, the effect of interfund activities has been removed from these statements. Governmental activities, which normally are supported by intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on sales, fees, and charges for support. Fiduciary funds are not included in these financial statements due to the unavailability of fiduciary funds to aid in the support of government programs.

The statement of net assets presents the reporting entity's non-fiduciary assets and liabilities, the difference between the two being reported as net assets. Net assets are reported in three categories: 1) invested in capital assets net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets; 2) restricted net assets - resulting from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation. 3) unrestricted net assets - those assets that do not meet the definition of restricted net assets or invested in capital assets.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function. Internally dedicated resources are reported as general revenues.

Funds are characterized as either major or non-major funds. Major funds are those funds whose assets, liabilities, revenues, or expenditures/expenses are at least ten percent of the corresponding total (assets, liabilities, etc.) for all funds or type (governmental or proprietary funds) and whose total assets, liabilities, revenues, or expenditures/expenses are at least five percent of the corresponding total for all governmental and enterprise funds combined. The Authority may also designate any fund as a major fund. The Jail Authority has no non-major funds.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds. Major individual governmental funds and major enterprise funds are reported as separate columns in the financial statements.

Governmental Funds

The Jail Authority reports the following major governmental funds:

General Fund:

This is the primary operating fund of the Three Forks Regional Jail Authority. It accounts for all financial resources of the general government, except where management requires that a separate fund be used for some function.

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Government-wide and Fund Financial Statements (Continued)

Debt Service Fund:

Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 Fund is presented as a debt service fund. Debt service funds are to account for the accumulation of resources for, and the payment of general long term debt principal and interest payments.

Proprietary Funds

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with proprietary funds' principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal operating revenues of the Jail Authority's enterprise fund are charges to customers for sales in the Jail Commissary Fund. Operating expenses for the enterprise fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. The Jail Authority has elected not to adopt Financial Accounting Standards Board (FASB) Statements or Interpretations issued after November 30, 1989, unless the Governmental Accounting Standards Board (GASB) specifically adopts such FASB Statements or Interpretations.

The Jail Authority reports the following major proprietary fund:

Jail Commissary Fund - The canteen operations are authorized pursuant to KRS 441.135(1), which allows the jailer to sell snacks, sodas, and other items to inmates. The profits generated from the sale of those items are to be used for the benefit or recreation of the inmates. KRS 441.135(2) requires the jailer to maintain accounting records and report annually to the participating county's county treasurer the receipts and disbursements of the Jail Commissary Fund.

Fiduciary Funds

Fiduciary funds are reported using the economic resources measurement focus and the modified cash basis of accounting. Fiduciary funds report only those resources held in a trust or custodial capacity for individuals, private organizations, or other governments. The Three Forks Regional Jail Authority's agency fund is used to account for monies held by the Authority in the Prisoner Fund for custodial purposes only. Unlike other funds, the agency fund reports assets and liabilities only; therefore, it has no measurement focus.

The Jail Authority reports the following fiduciary fund:

Prisoner Fund - This fund accounts for funds received from inmates to be used to purchase goods from the Jail's Commissary.

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

E. Deposits and Investments

The Jail Authority's cash and cash equivalents are considered to be cash on hand, demand deposits, certificate of deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

KRS 66.480 authorizes the Jail Authority to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

F. Capital Assets

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, and equipment that have a useful life of more than one reporting period based on the Jail Authority's capitalization policy, are reported in the applicable governmental or business-type activities of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost when purchased or constructed.

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction In Progress are not depreciated. Interest incurred during construction is not capitalized. Capital assets are depreciated using the straight-line method of depreciation over the estimated useful life of the asset.

	Capitalization Threshold	Useful Life (Years)
Land Improvements	\$ 12,500	10-60
Buildings and Building Improvements	\$ 25,000	10-75
Machinery and Equipment	\$ 2,500	3-25
Vehicles	\$ 2,500	3-25

G. Long-term Obligations

In the government-wide financial statements and proprietary fund financial statements, long term debt and other long-term obligations are reported as liabilities. The principal amount of bonds, notes and financing obligations are reported.

In the fund financial statements, governmental fund types recognize bond interest, as well as bond issuance costs when received or when paid, during the current period. The principal amount of the debt and interest is reported as expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures. Debt proceeds are reported as other financing sources.

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

H. Fund Equity

In the fund financial statements, the difference between the assets and liabilities of governmental funds is reported as fund balance. Fund balance is divided into reserved and unreserved components, with unreserved considered available for new spending. Unreserved fund balances, may be divided into designated and undesignated portions. Designations represent the Authority's intended use of the resources and should reflect actual plans approved by the Authority.

Governmental funds report reservations of fund balance for amounts that are legally restricted by outside parties for use for a specific purpose and encumbrances, if applicable.

I. Budgetary Information

An annual budget is adopted on the cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The Three Forks Regional Jail Authority is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The Authority may change the original budget by transferring appropriations at the activity level; however, the Authority may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

A formal budget is not adopted for the Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 Fund. The Governor's Office for Local Development does not require this fund to be budgeted.

Note 2. Deposits

The Authority maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the Jail Authority and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. However, as of August 31, 2003, the collateral and the FDIC insurance together did not equal or exceed the amount on deposit, leaving \$9,242 of public funds uninsured and unsecured. In addition, the depository institution did not have a written agreement with the Jail Authority securing the Jail Authority's interest in the collateral during the entire fiscal year 2004.

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 2. Deposits (Continued)

The Jail Authority's deposits are categorized below to give an indication of the level of risk assumed by the Jail Authority as of August 31, 2003:

	Bank Balance
FDIC Insured	\$ 100,000
Uncollateralized and uninsured	9,242
Total	<u>\$ 109,242</u>

Note 3. Capital Assets

Capital asset activity for the year ended June 30, 2004 was as follows:

	Reporting Entity		
	Beginning Balance	Increases	Ending Balance
Primary Government:			
<u>Governmental Activities:</u>			
Capital Assets Not Being Depreciated:			
Land and Land Improvements	\$ 42,108	\$	\$ 42,108
Total Capital Assets Not Being Depreciated	42,108		42,108
Capital Assets, Being Depreciated:			
Buildings	5,118,684		5,118,684
Vehicles and Equipment	36,321		36,321
Total Capital Assets Being Depreciated	5,155,005		5,155,005
Less Accumulated Depreciation For:			
Buildings	(272,996)	(136,498)	(409,494)
Vehicles and Equipment	(11,844)	(7,343)	(19,187)
Total Accumulated Depreciation	(284,840)	(143,841)	(428,681)
Total Capital Assets, Being Depreciated, Net	4,870,165	(143,841)	4,726,324
Governmental Activities Capital Assets, Net	<u>\$ 4,912,273</u>	<u>\$ (143,841)</u>	<u>\$ 4,768,432</u>
<u>Business-Type Activities:</u>			
Capital Assets, Being Depreciated:			
Vehicles and Equipment	\$ 22,900	\$	\$ 22,900
Total Capital Assets Being Depreciated	22,900		22,900
Less Accumulated Depreciation For:			
Vehicles and Equipment	(3,664)	(3,664)	(7,328)
Total Accumulated Depreciation	(3,664)	(3,664)	(7,328)
Total Capital Assets, Being Depreciated, Net	19,236	(3,664)	15,572
Business-Type Activities Capital Assets, Net	<u>\$ 19,236</u>	<u>\$ (3,664)</u>	<u>\$ 15,572</u>

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 3. Capital Assets (Continued)

Depreciation expense was charged to functions of the Jail Authority as follows:

Governmental Activities:

Protection to Persons and Property	
Building	\$ 136,498
Vehicles and Equipment	<u>7,343</u>
Total Depreciation Expense - Governmental Activities	<u>\$ 143,841</u>

Business-Type Activities

Jail Canteen	<u>\$ 3,664</u>
Total Depreciation Expense - Business Activities	<u>\$ 3,664</u>

Note 4. Short-term Debt - Financing Obligations

KADD Lease - Series 2003 B

On March 2, 2003, the Lee County Judge Executive, on behalf of the Three Forks Regional Jail Authority, entered into a \$165,000 lease agreement with the Kentucky Area Development District Financing Trust for the purpose of renovation and improvements to the jail facilities. The purpose of the original KADD lease was for renovations and improvements to the jail facilities. Terms of this lease agreement stipulated a one-year repayment schedule with semi annual interest payments and one annual principal payment to be paid in full. As of June 30, 2004, the Three Forks Jail Authority paid the lease in full by refinancing with a new 2004 E KADD lease.

KADD Lease - Series 2004 E

On May 7, 2004, the Lee County Judge Executive, on behalf of the Three Forks Regional Jail Authority, entered into a \$170,000 lease agreement with the Kentucky Area Development District Financing Trust for the purpose of refinancing a 2003 KADD lease. The purpose of the original KADD lease was for renovations and improvements to the jail facilities. Terms of this lease agreement stipulate a one-year repayment schedule with semi annual interest payments and one annual principal payment to be paid in full.

Changes In Short-term Liabilities

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Series 2003 B KADD Lease	\$ 165,000	\$	\$ 165,000	\$	\$
Series 2004 E KADD Lease		<u>170,000</u>		<u>170,000</u>	<u>170,000</u>
Financing Obligations Payable	<u>\$ 165,000</u>	<u>\$ 170,000</u>	<u>\$ 165,000</u>	<u>\$ 170,000</u>	<u>\$ 170,000</u>

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 5. Long-term Debt

A. First Mortgage Revenue Bonds, Series 2000

In December 2000, the Three Forks Public Properties Corporation issued \$6,295,000 in First Mortgage Revenue Bonds Series 2000. The proceeds from these bonds were used to construct the Three Forks Regional Jail. The only source of funds expected by the Three Forks Public Properties Corporation to meet the debt service on the bonds are the rental payments from the participating counties of Lee, Wolfe, and Owsley. Each of the three counties covenant to meet its own proportionate share of the debt service requirements on the bonds as follows:

Per the Management Agreement

Lee County	\$2,400,000	40%
Owsley County	\$1,395,000	22%
Wolfe County	\$2,500,000	38%

These bonds are scheduled to mature in December 2031 and have a variable interest rate from 5.50% to 6.40%. Semiannual interest payments are required in June and December and the principal amount is due each December. As of June 30, 2004, the principal outstanding was \$6,130,000. Debt service requirements for fiscal years ending June 30, 2004, and thereafter are as follows:

Fiscal Year Ended June 30	Governmental Activities	
	Principal	Interest
2005	\$ 85,000	\$ 366,588
2006	90,000	361,775
2007	95,000	356,688
2008	100,000	351,325
2009	110,000	345,550
2010-2014	645,000	1,628,064
2015-2019	875,000	1,420,440
2020-2024	1,200,000	1,129,236
2025-2029	1,650,000	686,758
2030-2031	1,280,000	126,400
Totals	<u>\$ 6,130,000</u>	<u>\$ 6,772,824</u>

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 5. Long-term Debt (Continued)

B. Financing Obligation

On August 1, 2002, the Three Forks Regional Jail entered into an agreement with Citizens Bank & Trust Co. of Jackson for the purchase of a van to transport work release inmates. The principal amount of the agreement was \$18,900 with a five percent (5%) interest rate. The agreement requires 36 monthly payments to be paid in full August 1, 2005. The principal balance outstanding as of June 30, 2004 was \$6,705. Payments for the remaining years are:

Fiscal Year Ended June 30	Governmental Activities	
	Principal	Interest
2005	\$ 6,511	\$ 201
2006	194	4
Totals	<u>\$ 6,705</u>	<u>\$ 205</u>

C. Changes In Long-term Liabilities

Long-term liability activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Primary Government:					
<u>Governmental Activities:</u>					
Revenue Bonds	\$ 6,215,000	\$	\$ 85,000	\$ 6,130,000	\$ 85,000
Governmental Activities Long-term Liabilities	<u>\$ 6,215,000</u>	<u>\$ 0</u>	<u>\$ 85,000</u>	<u>\$ 6,130,000</u>	<u>\$ 85,000</u>
<u>Business-Type Activities:</u>					
Financing Obligations	\$ 12,884	\$	\$ 6,179	\$ 6,705	\$ 6,511
Business-Type Activities Long-term Liabilities	<u>\$ 12,884</u>	<u>\$ 0</u>	<u>\$ 6,179</u>	<u>\$ 6,705</u>	<u>\$ 6,511</u>

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 6. Employee Retirement System

The Three Forks Regional Jail Authority has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost-sharing multiple-employer defined benefit pension plan which covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members. Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. The Jail Authority's contribution rate for nonhazardous employees was 7.34 percent.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by telephone at (502) 564-4646.

Note 7. Insurance

For the fiscal year ended June 30, 2004, Three Forks Regional Jail Authority was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

Note 8. Subsequent Events

During the course of the audit and review of subsequent events, we noted the following:

- Key staff turnover including the jail administrator, fiscal manager and class D coordinator. From December 2003 through May 27, 2005, there have been three jail administrators and two interim jail administrators. Also, it should be noted there has been a change on the Authority Board with a new Chairperson and Secretary.
- On December 1, 2000, Fifth Third Bank issued \$6.295 million of Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 for the construction of the Three Forks Regional Jail. In March of 2004, the Bank of New York acquired the bond holdings of the Fifth Third Bank. On December 22, 2004, the Bank of New York declared the Three Forks Public Properties Corporation in default. The Jail Authority had been using monies from its debt service reserve account, which is in the Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 Fund, to make the scheduled debt service payments of the Jail Authority. The Jail Authority would utilize the reserve account when they did not have enough money from operating income. The Jail Authority attempted to replenish the debt service reserve account when funds later became available. However, with increasing financial obligations, the Jail Authority could no longer replenish the reserve account in a timely manner.

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2004
(Continued)

Note 8. Subsequent Events (Continued)

In order to alleviate the reserve fund default, Lee, Owsley and Wolfe counties agreed to apply coal severance tax monies appropriated by the Kentucky General Assembly from budget memorandum HB 267 (2005 Session of the General Assembly) FCC Volume 1a. HB 267 appropriated \$300,000 from Lee, \$100,000 from Wolfe, and \$100,000 from Owsley Counties totaling \$500,000 for jail operations. These monies were in turn given to the Jail Authority. In April 2005, the Jail Authority wired \$264,339 to the Bank of New York to replenish the debt service reserve account and \$164,311 to pay off a Kentucky Area Development Districts Financing Trust, Series 2004 E, lease agreement. The remaining coal severance monies were applied to the current scheduled debt payment and other operating expenditures. Again the Authority has attempted to replenish this account in order for it to be used for its intended purpose. As of May 27, 2005, the bank balance in the account was \$40,274. The debt service payment due June 1, 2005 is \$38,410, which if paid out of these funds, will leave \$1,864.

As noted above, during fiscal year 2005, the Authority utilized HB 267 money for both debt reserve replenishment and operating expenditures. This is not a recurring receipt.

- The Authority is reporting an operating loss of \$68,665 for fiscal year ending June 30, 2004. In our review of subsequent events, we noted that as of May 27, 2005, the Authority has \$135,343 in outstanding and past due bills.
- The Board did not approve all expenditures prior to payment and did not seek pre-approval of recurring expenditures from the State Local Finance Officer. While conducting audit procedures, we were informed that on January 19, 2005 the jail administrator purchased a \$5,180 car without the Authority's approval. This vehicle was purchased mainly for the jail administrator use, however it was paid for through the commissary fund.

Note 9. Jail Commissary Fund

During the year, the Jail Authority discontinued the operations of the Jail Commissary Fund and turned it over to Swanson Services Corporation. For the fiscal year ended June 30, 2005, the Jail Commissary Fund will be converted to a special revenue fund.

Note 10. Going Concern

There is a going concern as to the ability of the Three Forks Regional Jail Authority to continue to operate. The Jail Authority has attempted to increase its funding by having the participating counties pay for actual beds utilized by those counties at a price of \$25 per day per prisoner. The Jail Authority has also sought to increase the prisoner population with other counties. The Jail Authority is expanding the old library to house 11-12 additional prisoners. As of July 1, 2005, the General Assembly will increase the reimbursement rate for state prisoners to \$30.51, which is a \$4 per inmate increase. In addition, the Board has discussed borrowing funds to alleviate past due expenditures.

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**THREE FORKS REGIONAL JAIL AUTHORITY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis**

For The Year Ended June 30, 2004

THREE FORKS REGIONAL JAIL AUTHORITY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis

For The Year Ended June 30, 2004

GENERAL FUND				
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Charges for Services	\$ 1,590,594	\$ 1,590,594	\$ 1,547,567	\$ (43,027)
Miscellaneous	9,000	9,000	21,929	12,929
Total Revenues	\$ 1,599,594	\$ 1,599,594	\$ 1,569,496	\$ (30,098)
EXPENDITURES				
Protection to Persons and Property				
Office of Administration				
Salaries -				
Administrator	\$ 45,600	\$ 45,600	\$ 49,418	\$ (3,818)
Deputies/Matrons	386,880	386,880	381,712	5,168
Medical Personnel	34,320	34,320	36,546	(2,226)
Secretary/Bookkeeper	49,920	49,920	49,451	469
Cooks	52,000	52,000	56,105	(4,105)
Maintenance Staff	22,526	22,526	30,506	(7,980)
Operations				
Prisoner Clothing	1,500	1,500	1,823	(323)
Staff Clothing	4,600	4,600	4,696	(96)
Cleaning Supplies	19,800	19,800	30,181	(10,381)
Kitchen Supplies	1,800	1,800	2,022	(222)
Office Supplies	3,600	3,600	3,903	(303)
Supplies - Other	5,400	5,400	6,984	(1,584)
Medical Services	11,280	11,280	27,939	(16,659)
Pest Control	900	900		900
Food	127,200	127,200	169,689	(42,489)
Gasoline	1,500	1,500	1,550	(50)
Linens	1,200	1,200	1,810	(610)
Prisoner Hygiene	2,040	2,040	2,683	(643)
Routine Medical	19,020	19,020	16,830	2,190
Travel	4,500	4,500	2,183	2,317
Utilities	68,100	68,100	80,373	(12,273)
Miscellaneous Expense	3,960	3,960	6,895	(2,935)
Vehicles	180	180		180
Maintenance				
Building Repairs	1,800	1,800	15,914	(14,114)
Equipment Repairs	900	900	424	476
Equipment				
Communication	1,500	1,500	2,840	(1,340)
Date Processing	500	500		500
Food Service	700	700	9	691
Medical	500	500		500
Debt Service				
Bond Principal	271,800	271,800		271,800
Bond Interest	184,463	184,463		184,463

THREE FORKS REGIONAL JAIL AUTHORITY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2004
(Continued)

EXPENDITURES (Continued)

Administration

General Services				
Professional Service	6,960	6,960	7,313	(353)
Building and Property Insurance	43,500	43,500	104,628	(61,128)
Staff Training	600	600	753	(153)
Fringe Benefits				
Social Security	37,189	37,189	34,297	2,892
Retirement	43,398	43,398	37,807	5,591
Health Insurance	96,998	96,998	74,713	22,285
Unemployment	13,249	13,249	4,564	8,685
Worker's Compensation	19,020	19,020	28,551	(9,531)
Medicare	8,691	8,691	8,021	670
Total Expenditures	<u>\$ 1,599,594</u>	<u>\$ 1,599,594</u>	<u>\$ 1,283,133</u>	<u>\$ 316,461</u>
Excess of Revenues Over				
Expenditures Before Other				
Financing Sources			286,363	286,363
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds			40,097	40,097
Transfers To Other Funds			(334,728)	(334,728)
Total Other Financing Sources (Uses)	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ (294,631)</u>	<u>\$ (294,631)</u>
Net Changes in Fund Balance			(8,268)	(8,268)
Fund Balance - Beginning - July 1, 2003			67,978	67,978
Fund Balance - Ending - June 30, 2004	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 59,710</u>	<u>\$ 59,710</u>

THREE FORKS REGIONAL JAIL AUTHORITY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2004

Budgetary Information

The annual budget is adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The Three Forks Regional Jail Authority is required to submit estimated receipts and proposed expenditures to the Governor's Office for Local Development. The budget is prepared by fund, function, and activity and is required to be adopted by July 1.

The Authority may change the original budget by transferring appropriations at the activity level; however, the Authority may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

**THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS**

For The Year Ended June 30, 2004

**THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS**

Fiscal Year Ended June 30, 2004

NONCOMPLIANCES

1. Substantial Doubt Of Three Forks Regional Jail's Ability To Continue To Operate Within Current Financial Structure

Three Forks Regional Jail Authority has numerous control weaknesses and noncompliances that have led to the decline in its financial stability. These are our greatest concerns:

- On December 1, 2000, Fifth Third Bank issued \$6.295 million of Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 for the construction of the Three Forks Regional Jail. In March of 2004, the Bank of New York acquired the bond holdings of the Fifth Third Bank. On December 22, 2004, the Bank of New York declared the Three Forks Public Properties Corporation in default. The Jail Authority had been using monies from its debt service reserve account, which is included in the Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 Fund to make the scheduled debt service payments of the Jail Authority. The Jail Authority would utilize the reserve account when it did not have enough money from operating income. The Jail Authority attempted to replenish the reserve account when funds later became available. However, with increasing financial obligations, the Jail Authority could no longer replenish the reserve account in a timely manner. (See Comment #2)
- In order to alleviate the reserve default, Lee, Owsley and Wolfe counties agreed to apply coal severance tax monies appropriated by the Kentucky General Assembly from budget memorandum HB 267 (2005 Session of the General Assembly) FCC Volume 1a. HB 267 appropriated \$300,000 from Lee, \$100,000 from Wolfe, and \$100,000 from Owsley Counties totaling \$500,000 for jail operations. These monies were in turn given to the Jail Authority. In April 2005, the Jail Authority wired \$264,339 to the Bank of New York to replenish the debt service reserve account and \$164,311 to pay off a Kentucky Area Development District Financing Trust, Series 2004 E, lease agreement. The remaining coal severance monies were applied to the current scheduled debt payment and other operating expenditures. Again the Jail Authority has attempted to replenish this reserve account in order for it to be used for its intended purpose. As of May 27, 2005, the bank balance in the account was \$40,274. The debt service payment due June 1, 2005 is \$38,410, which if paid out of these funds, will leave \$1,864.
- As noted above, during fiscal year 2005, the Jail Authority utilized HB 267 money for both debt reserve replenishment and operating expenditures. This is not a recurring receipt. The Jail Authority should not rely on receiving additional appropriations in the future for operating shortfalls.
- The Jail Authority is reporting an operating loss of \$68,665 for fiscal year ending June 30, 2004. In our review of subsequent events, we noted that as of May 27, 2005, the Jail Authority has \$135,343 in outstanding and past due bills.

The Jail Authority has attempted to increase its funding by having the participating counties pay for actual beds utilized by those counties at a price of \$25 per day per prisoner. The Jail Authority has also sought to increase the prisoner population with other counties. However, no new agreements have been made as of May 27, 2005. The Jail Authority is expanding the old library to house 11-12 additional prisoners. As of July 1, 2005, the General Assembly will increase the reimbursement rate for state prisoners to \$30.51, which is a \$4 per inmate increase. In addition, the Board has discussed borrowing funds to alleviate past due expenditures.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

**1. Substantial Doubt Of Three Forks Regional Jail's Ability To Continue To Operate Within
Current Financial Structure**
 (Continued)

The Jail Authority should be able to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt or externally forced revision of its operations; however, there is a substantial doubt as to the entity's ability to continue as a going concern for the next year as of May 27, 2005. The financial plight of the Jail Authority could potentially impact the credit rating and financial stability of the three participating counties unless immediate, aggressive and accurate decisions are implemented. Each county passed an ordinance allowing an ad valorem tax to be levied only to the extent that the revenues or other receipts from taxes or other sources are not sufficient to provide for the full payment of the accruing interest and maturing principal on the bonds each year.

We recommend that the Jail Authority and the participating counties take critical steps to address the funding shortage. As noted in this comment and below, the Jail Authority, which is the governing body of Three Forks Regional Jail, needs to take a proactive approach in the financial management of the facility on a regular, routine basis. The Jail Authority needs to understand that it is fiscally responsible for the operations of the facility. Clearly, the Board and the participating counties need to revisit the fiscal structure of the authority and put measures in place to ensure obligations are met timely and appropriately.

Current Board Chairperson Richard Adams' Response:

1. Under points 1, 2, and 3, the Jail Authority agrees with conclusions of the Auditors.
 - a. Under #1 concerning the reported operating loss of \$68,665.00 for the fiscal year ending June 30, 2004 we anticipate that deficit will be remedied in two ways:

1) First, we have already passed a measure to bill all three of the owning counties for each inmate. That means there is no 15 inmate limit for each of the three counties. This measure was passed in April, and went into effect May 1st. The result was a \$26,000.00 increase for this month alone. The total are as follows:

<i>Lee County</i>	<i>\$17,825.00</i>
<i>Owsley County</i>	<i>\$22,800.00</i>
<i>Wolfe County</i>	<i>\$18,550.00</i>
<i>Total:</i>	<i>\$59,175.00</i>

The counties normally pay approximately \$11,462.00 each month for a total of \$34,386.00.

We do not yet know how this will average out for the year, but a fairly safe estimate of \$15,000.00 extra a month would result in a total increase in revenue of \$180,000.00 per year. This alone should cover the deficit.

2) The second thing is the \$4.00 per day increase per inmate that the state has approved for all state prisoners. We have averaged about 90 per day for the last year (For a high of 100 to a low of 70). If we keep only 80 state prisoners a day that would result in a yearly increase in revenue of \$116,800.00 per year.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

1. Substantial Doubt Of Three Forks Regional Jail's Ability To Continue To Operate Within Current Financial Structure
 (Continued)

3) The third project is the remodeling of the library into a cell to hold 12 inmates. We have had some delays on this but are seeking to move forward as quickly as possible. If we can bring this online it will generate the following:

For 12 state prisoners at \$30.00 per day (\$360 per day), or approximately \$131,000.00 per year.

4) If we had all this in place that would create an increase of \$427,800.00 per year.

We believe this will be sufficient to balance our budget; pay our bond payments; catch up on overdue bills; take care of normal increases in expenditures; and provide a cash reserve. Our problem is taking care of the bills until we get all three sources producing revenue.

2. Three Forks Regional Jail Authority Defaulted On Debt Service Reserve Account

The Bank of New York declared the Three Forks Public Properties Corporation First Mortgage Revenue Bonds Series 2000 in default as of December 22, 2004 because the debt service reserve account fell as much as \$235,148 below the minimum required balance of \$469,120.

The debt service reserve account is a separate and special account set up to protect bondholders by requiring the bond issuer to maintain a balance of 125% of the average annual debt service payable on the bonds. However, the Jail Authority did not understand the restrictions placed on this account.

We recommend the Jail Authority maintain the required minimum balance of \$469,120 in the debt service reserve account. Via an agreement with Bank of New York, Governor's Office for Local Development and the participating counties, the Jail Authority used the appropriated HB 267 (2005 Session of the General Assembly) coal severance to replenish the reserve account.

Current Board Chairperson Richard Adams' Response:

See comment #1

3. Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities

During the course of our audit, we noted the Jail Authority did not provide adequate oversight or monitoring of financial management activities:

- During our testing, we noted inadequate or missing supporting documentation
 - The Jail Authority could not provide credit card statements or invoices to support the statements for the period of July 2003 through June 2004. The credit card vendor provided duplicate statements. Of the purchases charged, our auditors could not determine the appropriateness of \$7,094 of purchases, questioned \$251 of expenditures and recommended \$71 of purchases be disallowed.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

3. Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
(Continued)

- Auditors could not determine if fuel purchases were appropriate due to lack of sufficient documentation.
- The Jail Authority could not locate bank deposit tickets and supporting documentation from July 2003 through September 2003, therefore, we could not determine the validity of the receipts.
- Auditors noted 2 expenditures that did not have supporting documentation. One of these was for a software update totaling \$2,500. The other was for \$1,572 of credit card purchases.
- Employee reimbursements were made without the appropriate approval or documentation. For example, a jail employee paid for a car repair out-of-pocket for \$550 and was reimbursed by check through the jail. The Jail Authority did not approve this expenditure and we could not determine if it was an appropriate expenditure of the facility. Another example is an employee purchased a cell phone and was reimbursed through the jail. These reimbursements occurred prior to Board approval.
- Lack of proper accounting practices and internal control
 - The fiscal manager did not properly post items to appropriate account codes. For example, payments for the inmate van were paid out of an operating account code instead of a debt service account code in the Commissary Fund. Interfund transfers were not accounted for or reported properly. Monies taken out of the Commissary fund for Jail fees (booking fees, commissary employee payroll, etc.) were recorded as an expense in the Commissary Fund and a receipt in the General Fund. These transactions should have been recorded as transfers in and out to prevent double booking of receipts and expenditures.
 - Financial activity from one fiscal year was commingled with other fiscal years.
 - Authentic dual signatures were not required on all checks. Employees were allowed to use a stamp containing a board member's signature for a second signature. The board member did not review the supporting documentation to ensure the expenditure was appropriate. In addition, the stamp was not kept in a secure location.
 - Prisoner fund bank reconciliations were not preformed.
 - Bank reconciliations were inaccurate and incomplete. A list of outstanding checks and deposits in transit were not attached to the bank reconciliation. In order to determine the validity of the bank reconciliation, we performed a detailed reconciliation, which materially agreed to the fiscal manager's reconciliation.
 - Bank deposits were not being made timely. During the course of our audit, we noted as many as 12 calendar days from the receipt of funds to the funds being deposited in the bank.
 - Testing indicated checkout sheets were not being completed daily and reconciled to bank deposits and the general ledger. This ensures all receipts are properly deposited and accounted for.
 - Imaged copies of the back of checks were not maintained with bank statements.
 - The Jail Authority did not maintain money in interest bearing accounts.
 - Checks were not issued in numerical sequence and some voided checks were not recorded properly. In addition checks were not kept in a secure location.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

3. Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
 (Continued)

- The Board did not approve all expenditures prior to payment and did not seek pre-approval of recurring expenditures from the State Local Finance Officer. While conducting audit procedures, we were informed that on January 19, 2005 the jail administrator purchased a \$5,180 car without the Authority's approval. This vehicle was purchased mainly for the jail administrator's use, however it was paid for through the commissary fund.
- We noted a lack of segregation of duties without consistent compensating control procedures in place. A compensating control could be administrator approval of procedures preformed by the fiscal manager.
- Lack of proper approval or inappropriate practices
 - The Jail Authority allowed personal checks and employee reimbursement checks to be cashed from the prisoner account.
 - The Jail Authority allowed the use of debit cards for various expenses.

During the course of the audit and review of subsequent events, we noted key staff turnover including the jail administrator, fiscal manager and class D coordinator. From December 2003 through May 27, 2005 there have been three jail administrators and two interim jail administrators. Also, it should be noted there has been a change on the Authority Board with a new Chairperson and Secretary.

Good internal controls dictate that adequate supporting documentation be maintained for all receipts and disbursements including credit cards statements. Improper recording of receipts and expenditures could lead to misstated financial statements. All original invoices should agree to corresponding purchase orders. Invoices should be reviewed and approved by the Board prior to payment including employee reimbursements. Credit cards and their use should be safeguarded. Employees should be reimbursed for out-of-pocket expenses only with an original receipt and proper Administrator approval. Employee reimbursements should be kept to a minimum. Audits should be completed timely.

Proper accounting procedures and internal control policies should be in place. All financial activity should be accurately posted to the general ledger. Dual signatures should be required on all checks. Bank statements with imaged copies of both front and back of checks should be properly kept and reconciled in a timely (usually within 30 days of statement date) and complete manner. Bank deposits should be made daily upon the completion of daily checkout procedures including posting to the general ledger. All expenditures should be approved prior to payment. Credit card use should be limited.

Sound management structure and oversight will ensure the stability and success of any operation especially by ensuring the solidity of key positions.

The failure to adequately provide or properly monitor financial management activities especially during periods of financial instability and key staff turnover increases the risk of materially misstated financial statements due to errors or omissions from fraud or improper reporting. Failure to provide proper oversight of financial activity leaves thousands of dollars at risk. Sound management and a good internal control structure are essential for the achievement of full oversight and accountability. Board members and staff should have sufficient skills and training to meet their responsibilities.

We recommend the Jail Authority take critical steps to provide adequate oversight and monitor financial management activities by doing the following:

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

3. Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities

(Continued)

- Develop procedures for retaining adequate supporting documentation for all financial transactions.
 - Reconcile and maintain receipts from credit card purchases to the appropriate billing statement to ensure accuracy of the charges. Receipts should be attached to the statements.
 - Agree approved purchase orders to original invoices for propriety.
- Develop procedures to ensure good accounting practices and internal control procedures are in place by doing the following:
 - Record and post all receipts and disbursements to the general ledger including transfers between funds (i.e. Commissary to General or General to Commissary).
 - Ensure all financing activity of the year is recorded properly.
 - Require dual signatures on all checks. Until proper control procedures are put into place, the use of a signature stamp should be prohibited.
 - Complete reconciliations within 30 days after the statement date and maintain bank statements with imaged copies of both front and back of checks. Agree reconciliation to the general ledger. Investigate and resolve discrepancies immediately. Attach a list of outstanding checks and deposits in transit.
 - Keep all checks in a secure location, issue checks numerically and mark applicable checks “void” and record as such.
 - The Board should approve and review all disbursements prior to payment. A list of expenditures should be provided to the Board noting the check number, vendor name and the amount of check. Also the Board may pre-approve recurring expenditures (i.e. utility bills and payroll) if proper documentation is submitted to the State Local Finance Officer annually. The fiscal manager should transfer \$5,180 from the general fund to the commissary fund for the car purchased by the administrator on behalf of the jail.
 - Maintain money in interest bearing bank accounts.
 - Make bank deposits daily.
 - Pay disbursements by check and require dual signatures on all checks. Review supporting documentation for appropriateness prior to signing the check.
 - Ensure audits are completed annually.
- Proper approval and appropriate practices should be maintained to:
 - Prohibit bank charges and credit card fees.
 - Prohibit cashing checks of any kind.
 - Prohibit the use of debit cards.

Current Board Chairperson Richard Adams' Response:

Did not provide adequate oversight or monitoring:

- a. *Concerning credit card invoices: The board will be discussing guidelines for the use of any and all credit cards.*
- b. *Fuel purchase: Guidelines will also be established to insure that all purchases are legitimate and documented.*

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

3. Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
 (Continued)

Current Board Chairperson Richard Adams' Response (Continued)

- c. Bank deposit tickets and supporting documentation-No response.*
- d. Software update of \$2500 and a \$1572 credit card purchase-No answer as of yet. Will investigate.*
- e. Employee reimbursements for out of pocket expenses. This will be eliminated and new procedures established to prevent fraud, abuse, or error.*
- f. Fiscal manager did not properly post items to appropriate account codes-Some of this was done in ignorance and has been discussed with the present fiscal officer to insure that we do not repeat the error. Inter-fund transfers will be examined carefully and procedures established to insure proper accounting practices.*
- g. Financial activity from one fiscal year commingled with another-This has been discussed with the present financial officer and care will be taken to insure that this does not happen again.*
- h. Dual signatures-Now required on all checks. Signature stamps have been eliminated. The administrator and one of two other board members will be required to sign all checks, except for commissary fund which will be signed by the fiscal officer and the chairman of the board.*
- i. Bank reconciliations: Working on this one.*
- j. Bank deposits: Have instructed both the fiscal officer and acting administrator to make sure that this is done in a timely manner.*
- k. Checkout sheets: Have to do more work on this one.*
- l. Imaged copies not with bank statements: This is to be corrected immediately.*
- m. Numerical sequence not followed with checks: Auditors have instructed our fiscal officer how to deal with this if it occurs and how to keep it from occurring.*
- n. Purchase of car by administrator: This was done without board authority and was unknown to the board. The board had agreed to purchase a vehicle for the administrator but did not give their authority to do so nor had we agreed as to the amount we would pay for that vehicle. Since the purchase was already finalized by the administrator the Board voted to go ahead and pay for the vehicle. The administrator was instructed that all such purchases must go through the board. Future administrators will be advised that this kind of action is against our policy and procedures.*
- o. Lack of segregation of duties...We are in the process of hiring a new administrator and the Board will emphasize the need for a more personal involvement in oversight of fiscal responsibility.*

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

3. Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
 (Continued)

Current Board Chairperson Richard Adams' Response (Continued):

- p. Lack of proper approval of inappropriate practices-debit cards will be eliminated. No personal checks to be cash from prisoner accounts.*
- q. The staff has been instructed to keep adequate supporting documentation for all receipts and disbursements for all business transactions.*
- r. Proper accounting procedures-Our fiscal officer is new and is aware of the need for improvement in this area. This is an area where we hope to continually improve upon as training of our fiscal officer continues and also when our new administrator is hired to make sure the policy and desires of the board are carried out in this area.*
- s. In reference to all accounting procedures the new administrator will be given the audit report and will be responsible for carrying out all the recommendations that the auditors have recommended, with board approval.*
- t. The checking account will be changed to an interest bearing account (in process); fiscal officer will be instructed to make deposits daily; and we have already implemented the dual signing of all checks, including any special accounts; general account; and commissary account.*
- u. Checks will be kept in a secure place, under lock and key in the office.*

4. Three Forks Regional Jail Authority Did Not Comply With The Governor's Office For Local Development Or Kentucky Revised Statutes

The Jail Authority did not follow the guidelines set forth in the instructional guide and policy manual issued by the State Local Finance Officer or applicable Kentucky Revised Statutes. Additional areas to be addressed are:

- The Jail Authority did not prescribe to the uniform system of accounts.
 - Appropriation ledgers did not include all checks that were written and two ledgers were not maintained.
 - Authority did not prepare a complete, accurate list of encumbrances for the year under audit.
 - Authority was not properly utilizing the purchase order system. For example, employees were paying for car repair purchases and cell phones prior to approval and subsequently receiving reimbursements.
- The enacted budget was not properly amended for receipt and expenditure changes.
- An annual report for the Jail Canteen Operations was not completed and presented to the Fiscal Courts of Lee, Owsley and Wolfe Counties.
- An annual financial statement was not published within 60 days of the end of the fiscal year.
- Deposits in the amount of \$9,242 were insufficiently pledged by depository institutions.
- The Jail Authority did not review administrative code.
- The Jail Authority does not have a written investment policy.
- The Code of Ethics does not include a nepotism policy.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

4. Three Forks Regional Jail Authority Did Not Comply With The Governor's Office For Local Development Or Kentucky Revised Statutes
 (Continued)

KRS 441.800§2(c) states that established regional jail authorities must "exercise the . . . duties of counties under . . . provisions of the Kentucky Revised Statutes related to the operations of jails." KRS 68.210 requires the State Local Finance Officer to "supervise the administration of accounts and financial operations" and prescribe a system of uniform accounting for all counties and county officials. KRS 68.240 requires each county to prepare a budget including but not limited to: . . . 'jail operations'." KRS 65.003 states, "Each code of ethics adopted . . . shall include but not be limited to provisions which set forth: (c) A policy on the employment of members of the families of officials or employees of the city, county. . . ."

We recommend the Jail Authority review, utilize and adhere to the Governor's Office for Local Development (GOLD) *Instructional Guide for County Budget Preparation and State Local Finance Officer Policy Manual* including the KRSs included within. We further recommend the Jail Authority seek guidance from GOLD.

Current Board Chairperson Richard Adams' Response:

Most of the things stated in this section was not known by the Board and was not brought up by either the chairman of the board nor by any of the administrators of the facility. Each of these items will be discussed by the board and new administrator and corrected.

5. Three Forks Regional Jail Authority Did Not Maintain, Record, And Report Capital Assets Properly

Capital assets are tangible and intangible assets acquired for use in operations that will benefit more than one fiscal period. According to Governmental Accounting Standards Board (GASB) Statement 34 paragraph 18, capital assets should be reported at historical cost. Exhaustible capital assets should be depreciated over their estimated useful lives. Capital asset records are necessary for proper asset valuation, adequate insurance coverage, internal control and long range planning for property and equipment.

The Jail Authority does not have an accurate listing of capitals assets, nor do they record depreciation for their capital assets. During FY04, the jail did not have a capitalization policy in place; however, on March 15, 2005 the Board adopted a capitalization policy.

The GOLD State Local Finance Officer *Instructional Guide for County Budget Preparation and State Local Finance Officer Policy Manual* details the procedures to follow when maintaining, recording and reporting capital assets.

As stated above, the Jail Authority has adopted a capitalization policy. This policy should be adhered to. In addition, the Jail Authority needs to maintain a master capital assets listing. All contracts, invoices, purchase orders, bidding documentation, receipts, deeds, etc., should be maintained and filed with asset records. An inventory count should be performed annually of all items over the capitalization threshold. Items purchased or disposed of should be recorded on the master capital assets listing accordingly. Capital assets and corresponding depreciation should be reported in accordance with GASB Statement 34 on the Jail Authority's financial statements. The Jail Authority should adhere to the GOLD policy referred to above.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

5. Three Forks Regional Jail Authority Did Not Maintain, Record, And Report Capital Assets Properly
 (Continued)

Current Board Chairperson Richard Adams' Response:

Steps have been made to correct the things listed under this section and every effort will be made to adhere to the standards listed in the GOLD Guide.

6. Discrepancies Were Noted In Three Forks Regional Jail Authority's Payroll

The following discrepancies were noted when conducting our test of payroll expenditures:

- Improper W-2 reporting
 - Retirement was not withheld as a pre-tax item; therefore employee retirement contributions were subject to federal taxation. Retirement contributions to the County Employees Retirement System (CERS) are exempt from federal taxation.
- Inconsistent application of overtime rates
 - Of the 11 payroll expenditures tested, two did not receive adequate overtime compensation based on the number of hours worked. Also, one of these employee's overtime rate was calculated incorrectly.
 - Two of 11 payroll expenditures were compensated for overtime in weeks that holiday time and leave time accounted for part of the hours over 40.
- Miscalculation of time
 - Out of 11 employee timesheets tested, two timesheet in/out times recorded did not agree to the daily total hours listed.
 - Inconsistent reporting of time on timesheets - some employees recorded lunch hours while others did not. Therefore, it was hard to determine actual hours worked.
- Retention of timesheets
 - Timesheets for 2001 and 2002 could not be located.
- Salary reimbursements from the Commissary Fund to the General Fund did not have appropriate documentation. Three employees were paid for their work in the Commissary by transferring funds out of the commissary fund to the general fund. Amounts paid for FY04 were \$30,704 and for FY03, \$30,792. These are not necessarily disallowed expenditures, however supporting documentation should be maintained to alleviate any question as to their validity.
- Retirement was not withheld nor paid from an incentive payment to the former administrator. In addition, the Authority did not provide the corresponding matching requirements for the retirement contributions that should have been withheld.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

6. Discrepancies Were Noted In Three Forks Regional Jail Authority's Payroll

(Continued)

- Leave balances not accrued/compensated correctly.
 - According to the *Three Forks Regional Jail Policies and Procedures Manual*, vacation leave is to be accrued at the rate of one day per calendar month, not to exceed 80 hours of accrued vacation leave per year, the balance of which is to be compensated on December 15 of any given year. Vacation leave was not accrued according to this guideline. In addition, employee leave balances exceeded the 80-hour threshold and balances were compensated upon termination of employment, not on December 15. Also, there is no limit on the number of sick leave hours that can be accumulated, however, upon termination of employment, sick pay will not be paid. We found one instance where a sick leave balance of \$2,022 was paid upon termination. We also found one instance where \$810 was paid to an employee upon termination for annual leave above 80 hours.

Due to lack of oversight and not following policies and procedures, payroll amounts were not computed, documented and paid accurately and consistently. In some instances, payroll procedures were in direct violation of the jail's established policies and procedures.

According to 26 U.S.C.A. §414(h), the retirement payments are exempt from taxation.

According to KRS 337.285(1) "No employer shall employ any of his employees for a work week longer than forty (40) hours, unless such employee receives compensation for his employment in excess of forty (40) hours in a work week at a rate of not less than one and one-half (1½) times the hourly wage rate at which he is employed."

According to KRS 337.320 "Every employer shall keep a record of. . . the hours worked each day and each week by each employee. . . such records shall be kept on file for at least one (1) year after entry."

The Jail Authority or fiscal manager should:

- Contact the Internal Revenue Service and the Kentucky Department of Revenue for information and assistance in correcting the 2002 and 2003 calendar year retirement withholdings. Ensure that all compensation is subject to retirement withholdings and corresponding matching requirements are met.
- Ensure all employees are receiving proper compensation for any and all overtime. Any additional amounts due the employees should be paid.
- Adopt policies and procedures to address overtime pay and consistent reporting of time and compensation.
- Verify timesheets and check these for accuracy.
- Retain all timesheets for at least one year and until the audit is complete.

**THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)**

6. Discrepancies Were Noted In Three Forks Regional Jail Authority's Payroll

(Continued)

Current Board Chairperson Richard Adams' Response:

The Board will instruct the new administrator, as soon as possible, to correct the following:

- 1) *Improper W-2 reporting;*
- 2) *Overtime rates;*
- 3) *Miscalculation of time sheets;*
- 4) *Retention of time sheets (are now being kept for a 10 year period); supporting documentation will be provided for any transfers;*
- 5) *Will check on the retirement withholding error of past adm.;*
- 6) *Leave balances have already been corrected and the overpayments in the past should not occur in the future.*

7. Three Forks Regional Jail Authority Did Not Charge Or Submit Sales Tax On Their Commissary Sales

Three Forks Regional Jail operates a commissary for the use of the prisoners. The commissary may sell such items as candy, soap, toothbrushes etc. The jails may mark up these items and make a profit off of these sales. We found that the Jail is not charging the inmates sales tax on these items.

The sales tax is imposed on the gross receipts derived from both retail sales of tangible personal property and sales of certain services to the final customer in Kentucky. Commissary sales are subject to sales tax. There is no blanket exemption for governmental or non-profit entities for receipts from the sale of tangible personal property even though there may be an exemption on purchases by such entities.

We recommend that the Three Forks Regional Jail begin charging inmates for sales tax on all applicable commissary sales. This tax should then be reported and paid to the Kentucky Department of Revenue. Three Forks Regional Jail should file an application with the Department of Revenue for a tax identification number. When this is done, the Department of Revenue will send the jail appropriate forms to submit payments monthly.

Current Board Chairperson Richard Adams' Response:

The sales tax issue will soon be corrected.

8. Three Forks Regional Jail Authority Commissary Fund Expenditures Were Not Used For The Benefit Or Recreation Of The Inmates

Two expenditures were identified during the testing of Jail Commissary expenditures in which profit expenditures from the commissary were used for something other than for the benefit or recreation of the inmates. These expenditures were for Sheriff's Office Management Systems (SOMS) software which the jail uses to track inmates. KRS 441.135(2) states, "All profits from the canteen shall be used for the benefit or recreation of the prisoners." Disallowed Jail Commissary expenditures totaled \$4,500 and must be reimbursed to the Jail Commissary Fund from the General Fund. We recommend that the Jail Authority reimburse the Commissary Fund for the disallowed expenditures. We also recommend the Jail Authority ensure profit expenditures from the Jail Canteen be used only for the benefit or recreation of the inmates.

THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)

8. Three Forks Regional Jail Authority Commissary Fund Expenditures Were Not Used For The Benefit Or Recreation Of The Inmates
 (Continued)

Current Board Chairperson Richard Adams' Response:

Funds improperly used from the Commissary Fund will be reimbursed as soon as we are able to do so.

REPORTABLE CONDITIONS

9. Three Forks Regional Jail Authority Should Establish Formal Policies Concerning Access To Computer System Resources

Our review of computer system security controls at the Three Forks Regional Jail (Jail) revealed that formalized system usage and security policies had not been developed, nor had formalized procedures for providing system access been developed.

Requests for activations, changes, or terminations of user accounts are usually obtained verbally or through e-mail. No formal access request form or process exists to document proper authorization for system access. Finally, though we did note that employees are required to sign confidentiality agreements and certain formal policies do exist, the current policies do not include procedures concerning system security administration or user responsibilities.

Failure to adequately document and communicate acceptable computer security and usage policies could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This increases the likelihood of unauthorized data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

Formalized policies should be established for controls over logical system access to help ensure only authorized users are granted access to the system. These policies should include requirements for management authorization of access requests; procedures for requesting new system access, changes to existing system access, termination of system access, and documentation of appropriate authorization for system access and subsequent changes. Additionally, system users should be made aware of their responsibilities concerning data confidentiality, as well as appropriate and efficient usage of Jail system resources.

We recommend that the Jail establish formal computer security and acceptable use policies that address both the logical security and computer usage responsibilities for the Jail's system security administrator and users. These policies should include, but not be limited to:

- Use of a formal system access request form that requires signoff by an authorized member of management, which would be used for establishment, deletion, or alteration of a user access.
- Maintenance of request forms in either electronic or hardcopy format to allow for review by internal management or auditors.
- Procedures for establishing, deleting, or making other modifications to user access.
- Documentation of system administration and user responsibilities concerning data confidentiality and appropriate usage of system resources such as E-mail and the Internet.

Further, after completion of these policies, all the current and future system users should be made aware of the policies implemented concerning the acceptable use of system services.

**THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)**

9. Three Forks Regional Jail Authority Should Establish Formal Policies Concerning Access To Computer System Resources
(Continued)

Current Board Chairperson Richard Adams' Response:

Both of these will be addressed by Board and the new administrator to ensure the security of our computer system.

10. Three Forks Regional Jail Authority Should Strengthen Network Logical Security

Our review of logical access security for the Three Forks Regional Jail (Jail) local area network (LAN) revealed that network security was not adequate. Specifically, no user authentication is necessary to gain access to the LAN personal computers (PCs). Most application software residing on the Jail's PCs require a user ID and password such as ORION (Offender Records Information Operations Network), SOMS (Sheriffs Office Management System) and COBRA commissary software. However, Quickbooks software maintained on the bookkeeper's PC within the administration office did not require a user ID and password. Therefore, anyone with access to that room could logon to that PC and access the Quickbooks software and all related data. Quickbooks is used at the jail to document critical financial transactions including general fund transactions, revenue receipts, Commissary transactions, and to print checks.

Further, since anyone with physical access to the PCs can gain access to the hard drives, they could gain access to sensitive data and system files, including underlying databases. These computers held sensitive data such as inmate information and E-mail files. Though physical access controls at the facility were significant, the PCs within the Administration office were accessible to the jail administrator, bookkeeper, and shift commander. All three individuals could gain access to Quickbooks. This provided an insufficient segregation of duties based on access that could be obtained by these individuals.

Finally, it was noted that the Jail currently did not have a qualified computer system administrator on staff. Based on our discussions with Jail personnel, the Jail was in the process of interviewing and hiring someone that would have the qualifications necessary for system administration.

The LAN security conditions appear to be due to a lack of system personnel with adequate training to help ensure proper security measures are established. Therefore, the only security measures that appear to be in place are those established by outside vendors concerning their supported software. The physical access controls assist in limiting any vulnerability to the individuals with access to the administrative office.

Proper network security requires strong user authentication for system access to properly safeguard system resources and to provide an adequate audit trail of exactly what users process specific transactions or make changes to system files. In addition, failure to maintain proper segregation of duties for system users increases the likelihood that unauthorized changes to data can be made or that unauthorized processes can be performed.

**THREE FORKS REGIONAL JAIL AUTHORITY
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2004
(Continued)**

**10. Three Forks Regional Jail Authority Should Strengthen Network Logical Security
(Continued)**

In combination with the formal security policies and procedures we have discussed in a separate comment, we recommend that the Jail institute procedures to ensure strong LAN access security controls. Strong user authentication controls should be required to obtain access to the LAN and those controls should be established in a manner to ensure proper segregation of duties between bookkeeping, Jail administration, and non-administrative duties. Further, Jail administration should consider implementing additional security for Quickbooks on the bookkeeping PC, such as a separate user ID and password specifically for that software. Finally, we recommend the jail obtain an employee with adequate system administration capabilities or train current staff to perform those duties.

Current Board Chairperson Richard Adams' Response:

See Comment #9

Current Board Chairperson Richard Adams Overall Audit Response:

I can assure the Office of the Auditor of Public Accounts that the Board and the new administrator will be working on each of these points to make sure they are resolved for the proper administration of the Three Forks Regional Jail. Some we have already implemented; some will be addressed immediately; and some will take a little while to solve.

In this next month we must prepare a budget for the next fiscal year; solve some financial challenges; prepare to begin a new audit for 2005; hire a new administrator; and more.

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Richard Adams, Chairperson of the Three Forks Regional Jail Authority
Members of the Three Forks Regional Jail Authority

**Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards**

We have audited the financial statements of the governmental activities, the business-type activities, and each major fund of Three Forks Regional Jail Authority, Kentucky, as of and for the year ended June 30, 2004, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated May 31, 2005. The Jail Authority presents its financial statements in accordance with the modified cash basis of accounting which is a comprehensive basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Three Forks Regional Jail Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Three Forks Regional Jail Authority's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying comments and recommendations.

- Three Forks Regional Jail Should Establish Formal Policies Concerning Access To Computer System Resources
- Three Forks Regional Jail Authority Should Strengthen Network Logical Security

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatement caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we do not consider them to be material weaknesses.



Report On Internal Control Over Financial Reporting
And On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Three Forks Regional Jail Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of material noncompliance that are required to be reported under Government Auditing Standards and which are described in the accompanying comments and recommendations.

- Substantial Doubt Of Three Forks Regional Jail's Ability To Continue To Operate Within Current Financial Structure
- Three Forks Regional Jail Authority Defaulted On Debt Service Reserve Fund
- Three Forks Regional Jail Authority Did Not Provide Adequate Oversight Or Monitoring Of Financial Activities
- Three Forks Regional Jail Authority Did Not Comply With Governor's Office For Local Development Or Kentucky Revised Statutes
- Three Forks Regional Jail Authority Did Not Maintain, Record, And Report Capital Assets Properly
- Discrepancies Were Noted In Three Forks Regional Jail Authority's Payroll
- Three Forks Regional Jail Authority Did Not Charge Or Submit Sales Tax On Their Commissary Sales
- Three Forks Regional Jail Authority Commissary Fund Expenditures Were Not Used For The Benefit Or Recreation Of The Inmates

This report is intended solely for the information and use of management and is not intended to be, and should not be, used by anyone other than the specified party.

Respectfully submitted,

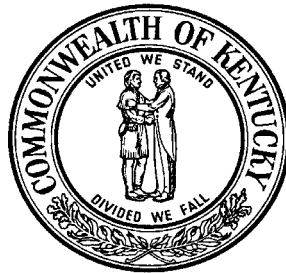


Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
May 31, 2005

**REVIEW OF
THREE FORKS REGIONAL JAIL - CONSTRUCTION RELATED
COSTS AND SPECIFIED FINANCIAL STATEMENT ASSERTIONS**

**For The Fiscal Years Ended
June 30, 2002 and 2003**



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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Independent Accountant's Report

We have reviewed the Three Forks Regional Jail construction related costs and the specified financial statement assertions for the fiscal years ended June 30 2002 and 2003. Three Forks Regional Jail Authority and Three Forks Regional Jail management is responsible for all construction related costs of the Jail and the specified financial statement assertions of the jail for FYE June 30, 2002 and 2003.

Our review was conducted in accordance with attestations standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the construction related costs and specified financial statement assertions of the jail for FYE June 30, 2002 and 2003. Accordingly, we do not express such an opinion.

Based on our review, there were issues that came to our attention regarding both construction and specified financial statement assertions of the jail for FYE June 30, 2002 and 2003. One of these comments is enclosed within this report. The other comments are disclosed in the FYE June 30, 2004 audit report.

- Three Forks Regional Jail Authority Did Not Adequately Oversee The Jail Construction

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Crit Luallen".

Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
May 31, 2005



**THREE FORKS REGIONAL JAIL - CONSTRUCTION RELATED COSTS
AND SPECIFIED FINANCIAL STATEMENT ASSERTIONS
COMMENT AND RECOMMENDATION
Fiscal Years Ended June 30, 2002 and 2003**

The following finding and recommendation was noted during our review of construction costs and specified financial statement assertions for fiscal years ending June 30, 2002 and June 30, 2003. However, additional comments were noted during our review that also impacted our audit of the operations of Three Forks Regional Jail Authority for the period ending June 30, 2004. Rather than present these findings in both reports, we have elected to present those findings only within the body of the audit report. Therefore, that report should be read in conjunction with this report to obtain additional findings and recommendations.

Three Forks Regional Jail Authority Did Not Adequately Oversee The Jail Construction

During our review of the construction expenditures for the Three Forks Regional Jail, the following items came to our attention:

- Discrepancies were noted between the bond final official statement, the management agreement and the lease and sublease agreements describing the participation level for each participating county. The management agreement as well as the lease and sublease agreements state participation levels of 40% for Lee County, 22% for Owsley County and 38% for Wolfe County, while the bond final official statement stated \$1.395 million or 22% for Lee County, \$2.4 million or 38% for Owsley and \$2.5 million or 40% for Wolfe.
- The Jail Authority did not provide adequate oversight during the construction of the jail facility. No attempt was made by the Jail Authority to account for the financial activities related to the debt and construction of the jail, including change orders. It was the Jail Authority's understanding that the financial advisor and the construction manager would oversee all aspects of constructing the jail, including the bond issuance and related debt financing as well as overall accounting for all of the financial activity related to the project. Based upon interviews with both the financial advisor and the construction manager, they stated they were only responsible for the bond issuance and building construction respectively. However, this did not preclude the responsibility of the board to ensure the oversight of the facility construction.
- On January 31, 2003, the Board minutes noted the construction cost had exceeded its projected cost. The Board voted to approve a \$133,000 loan. On March 3, 2003, a one-year 2003 Series B Kentucky Area Development District Financing Trust lease was signed by the Lee County Judge/Executive on behalf of the Jail Authority in the amount of \$165,000. This lease was paid off with the 2004 Series E Kentucky Area Development District Financing Trust lease for \$170,000. This lease was signed by the Lee County Judge/Executive and dated May 7, 2004. However, the Board did not formally approve this debt. It was apparent the Board was not fully aware of these obligations and did not seek the State Local Finance Officer approval. Neither the Board nor Lee County Fiscal Court authorized these one-year leases.
- The Board Chairperson approved \$36,158 in change orders and did not seek Board approval. The Chairperson stated that she was given blanket approval by the board, however; approval could not be located in the board minutes. It was also noted that neither the Board Chairperson nor the Board approved \$46,336 of additional change orders, but these were reimbursed.

**THREE FORKS REGIONAL JAIL - CONSTRUCTION RELATED COSTS
AND SPECIFIED FINANCIAL STATEMENT ASSERTIONS
COMMENT AND RECOMMENDATION
Fiscal Years Ended June 30, 2002 and 2003
(Continued)**

Three Forks Regional Jail Authority Did Not Adequately Oversee The Jail Construction
(Continued)

- Bond proceeds of \$200,000 were wired to the Jail Authority during March 2002. This money was used to pay operating expenditures such as payroll and utility bills. Basically, this means the Jail Authority will pay interest on these operating expenditures over the 30-year life of the bond.
- Construction related bank statements were not properly accounted for or maintained by the Jail Authority. As many as 30 duplicate statements had to be provided by the trustee bank in order for us to complete review procedures of construction activity.
- The original bid price of the facility exceeded the projected cost. A value engineering study was completed which reduced the cost by \$270,000.

Sound management practices would dictate the Jail Authority take reasonable efforts to oversee the construction of its own facility. It would include seeking professional legal advice when appropriate and ensuring the project costs and related debt activity are maintained and properly accounted for.

Without sound management oversight and legal advice, the Jail Authority risked the loss of assets or misappropriation of assets; misunderstanding of commitments the Board may place upon the Jail Authority, and inadequate financial reporting which allows the potential for fraud and abuse.

KRS 65.944 states no local government may enter into a lease with a principal amount exceeding \$100,000 without first notifying the State Local Debt Officer in writing.

We recommend in the future, the Board take an active role in overseeing any construction project. The Board should have a clear understanding of its responsibility to protect the jail assets. The Board should seek legal counsel before entering into any formal agreements to ensure accuracy and appropriateness of the agreement. We further recommend the Jail Authority seek approval of any debt exceeding \$100,000 from the State Local Finance Officer in accordance with KRS 65.944.

Current Board Chairperson Richard Adams' Response:

1. Under points 1, 2, and 3, the Jail Authority agrees with conclusions of the Auditors.
 - b. Under #1 concerning the reported operating loss of \$68,665.00 for the fiscal year ending June 30, 2004 we anticipate that deficit will be remedied in two ways:

1) First, we have already passed a measure to bill all three of the owning counties for each inmate. That means there is no 15 inmate limit for each of the three counties. This measure was passed in April, and went into effect May 1st. The result was a \$26,000.00 increase for this month alone. The total are as follows:

<i>Lee County</i>	<i>\$17,825.00</i>
<i>Owsley County</i>	<i>\$22,800.00</i>
<i>Wolfe County</i>	<i>\$18,550.00</i>
<i>Total:</i>	<i>\$59,175.00</i>

The counties normally pay approximately \$11,462.00 each month for a total of \$34,386.00.

**THREE FORKS REGIONAL JAIL - CONSTRUCTION RELATED COSTS
AND SPECIFIED FINANCIAL STATEMENT ASSERTIONS
COMMENT AND RECOMMENDATION
Fiscal Years Ended June 30, 2002 and 2003
(Continued)**

Three Forks Regional Jail Authority Did Not Adequately Oversee The Jail Construction
(Continued)

Current Board Chairperson Richard Adams' Response:
(Continued)

1) (Continued)

We do not yet know how this will average out for the year, but a fairly safe estimate of \$15,000.00 extra a month would result in a total increase in revenue of \$180,000.00 per year. This alone should cover the deficit.

2) The second thing is the \$4.00 per day increase per inmate that the state has approved for all state prisoners. We have averaged about 90 per day for the last year (For a high of 100 to a low of 70). If we keep only 80 state prisoners a day that would result in a yearly increase in revenue of \$116,800.00 per year.

3) The third project is the remodeling of the library into a cell to hold 12 inmates. We have had some delays on this but are seeking to move forward as quickly as possible. If we can bring this online it will generate the following:

For 12 state prisoners at \$30.00 per day (\$360 per day), or approximately \$131,000.00 per year.

4) If we had all this in place that would create an increase of \$427,800.00 per year.

We believe this will be sufficient to balance our budget; pay our bond payments; catch up on overdue bills; take care of normal increases in expenditures; and provide a cash reserve. Our problem is taking care of the bills until we get all three sources producing revenue.

Auditor's note: Current Board Chairperson Adams' response is in reference to comments 1 and 2 of the Three Forks Regional Jail Authority Audit for the fiscal year ended June 30, 2004 as well as this comment.

***NOTE: DUE TO FILE SIZE LIMITATIONS, ALL APPENDICES MAY NOT BE ATTACHED HERE.
PLEASE CLICK ON THE DESIRED APPENDIX, AND YOU WILL BE REDIRECTED.**

LIST OF APPENDICES

APPENDIX A - INTERLOCAL COOPERATION AGREEMENT

APPENDIX B - ARTICLES OF INCORPORATION OF THREE FORKS PUBLIC PROPERTIES CORPORATION

APPENDIX C - FINAL OFFICIAL STATEMENT THREE FORKS PUBLIC PROPERTIES CORPORATION
FIRST MORTGAGE REVENUE BONDS SERIES 2000

APPENDIX D - MANAGEMENT AGREEMENT FOR THREE FORKS REGIONAL DETENTION CENTER

APPENDIX E - BANK OF NEW YORK DEFAULT NOTICE - FIRST MORTGAGE REVENUE BONDS
SERIES 2000

APPENDIX F - GOVERNOR'S OFFICE FOR LOCAL DEVELOPMENT CORRESPONDENCE RELATED TO
DEFAULT NOTICE

APPENDIX G - RENEWABLE REVENUE LEASE AGREEMENT KENTUCKY AREA DEVELOPMENT
DISTRICTS FINANCING TRUST 2004 SERIES E

APPENDIX H - STANDARD FORM OF AGREEMENT BETWEEN OWNER AND ARCHITECT

APPENDIX I - STANDARD FORM OF AGREEMENT BETWEEN OWNER AND CONSTRUCTION
MANAGER WHERE THE CONSTRUCTION MANAGER IS NOT A CONSTRUCTOR

APPENDIX J - CONTRACT OF AGREEMENT (FINANCIAL ADVISOR)

APPENDIX K - CODELL CONSTRUCTION LIST OF CHANGE ORDERS

APPENDIX L - QUESTIONABLE AND DISALLOWED EXPENDITURES

Auditor's note: These appendices are presented for informational purposes only. The Auditor of Public Accounts did not audit this data and does not express an opinion.